

THE ROLE OF THRIFT INSTITUTIONS  
IN  
BOSTON'S HOUSING MARKETS


by

RANDY KEITH VEREEN

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of the Requirements for the  
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## ABSTRACT

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Due to its high cost, most housing is purchased and repaired with borrowed capital. The availability of this borrowed capital is often the determining input into people's ability to meet their housing needs. The major source of this borrowed capital are the thrift institutions. The way that they distribute those funds to potential borrowers is one of the most crucial elements in the housing market. Often the process that they utilize to make the distribution decisions works against the inner city borrower. There is evidence to suggest that in many cases, the lenders actions are artificially conservative.

An analysis of all the institutions operating in Boston led to important insights in the peculiar nature of Boston's mortgage suppliers. This led to important concepts of the way to achieve change in the Boston market. A case study of one neighborhood thrift institution resulted in documentation of critical problems such as support of absentee-owners, "redlining", and disinvestment. Several ways to deal with these problems and influence their correction are explored.

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## CHAPTER I

## INTRODUCTION

Housing's role as the "premier U.S. consumer good" (1) dictates that the problems of urban housing are of paramount importance to all concerned about the quality of life in our cities. Consequently, it is important that one understand those unique characteristics of housing which contribute to its distinctiveness as an economic good and which form the basis for many of its problems.

If reasonably well built, housing can last for generations. This durability leads to a situation where only two to three percent of the total supply of housing comes from new construction. (2) The remainder comes from the existing stock. Consequently, new construction can not effectively respond to market demands. The time that it takes to carry new housing from an idea to occupancy is often measured in years. This time lag, coupled with the low percentage of the total stock that new construction constitutes, results in an extraordinarily stable supply of housing. Consequently, changes in demand are manifested (at least in the short run), by changes in the price of housing rather than immediate changes in supply.

As the demand for housing rises, so does the cost. The consumer either pays the increased cost or consumes less. If he is already consuming the lowest amount possible, he has no alternative but to allocate an

increased percentage of his income for housing. Therefore the very poor must often spend increasingly greater portions of their incomes on housing to maintain a minimal level of housing quality. Even moderate and often upper income people must spend one quarter of their income on housing. Inner city residents usually have to spend thirty to thirty-five percent of their income to acquire even modest shelter.(3)

The total expenditure of housing includes a high initial cost (if purchased) as well as a continuing outflow for maintenance and repair. Because housing expenditures are so great, generally, neither rental housing investors nor homeowners are able to accumulate enough savings to purchase housing or to make major repairs. Consequently, most of the funds for initial purchases and some of the upkeep funds (significant renovation and repair) do not come directly from the owner of the property. They are borrowed from other sources. Without borrowed funds very little housing would be built, purchased, or repaired. Therefore, the supply of borrowed capital is the determining input into people's ability to meet their housing needs. This results in housing being tied to the credit market to a degree unmatched by any other consumer good.

Residential mortgages are the largest users of available credit in the nation. In 1972 mortgages accounted for 23.7 percent of the total outstanding credit or \$422.8 billion. This is a significant increase from the

**TABLE 25 • Residential Mortgage  
Debt Outstanding and Annual  
Increase, 1947-1972**  
(Dollar Amounts in Billions)

Year	Total Residential Debt	Annual Increase	Percentage Increase
1947	\$ 34.8	\$ 5.7	19.6%
1950	55.3	9.1	19.7
1955	102.5	13.3	14.9
1960	161.6	12.0	8.0
1961	176.1	14.5	9.0
1962	192.3	16.2	9.2
1963	211.2	18.9	9.8
1964	231.1	19.9	9.4
1965	250.1	19.0	8.2
1966	264.0	13.9	5.6
1967	280.0	16.0	6.1
1968	298.6	18.6	6.6
1969	319.0	20.4	6.8
1970	338.2	19.2	6.0
1971	375.0	36.8	10.9
1972*	422.8	47.8	12.8

\*Preliminary.

Source: Federal Reserve Board.

Source: 1973 Savings and Loan Fact Book, p. 36

**TABLE 23 • Postwar Growth in Selected Types of Credit**  
(Billions of Dollars)

Type of Credit	1947	1972*	Increase
Total Credit Outstanding .....	\$366.2	\$1,783.9	\$1,417.7
Residential Mortgage Credit:			
One- to Four-Family Homes .....	28.2	346.2	318.0
Multifamily Units .....	6.6	76.6	70.0
Total .....	34.8	422.8	388.0
Corporate Bonds .....	27.2	200.2	173.0
State and Local Government Obligations .....	17.2	180.8	163.6
Consumer Credit .....	11.6	156.4	144.8
Mortgages on Commercial Properties .....	9.1	107.2	98.1
Federal Debt .....	220.8	344.2	123.4

\*Preliminary.

Sources: Federal Reserve Board; United States Savings and Loan League.

Source: 1973 Savings and Loan Fact Book, p. 32.

9.5 percent level of 1947.

As a consequence of both the role of credit in the housing market and the magnitude of residential mortgage credit, any influence on the supply of credit often has crucial implications for housing markets. There are two major types of actions which result in changes in the supply of mortgage credit. The first type of actions are influences on the flow of funds into "financial intermediaries", institutions which serve as conduits for the flow of funds from the private investor (saver) to the borrower. The most significant of these borrowers are those seeking funds for real estate mortgages. For the purposes of this paper the other type of actions is a more crucial area. It concerns influences on the flow of funds from the "financial intermediaries" to the borrower. It is not only important whether an institution has funds to lend but also, where the mortgaged property is located, the identity of the borrower, and the terms of the loan. Through the determination of these aspects of the lending decision, the financial institution exerts its greatest influence on the housing market.

There is one final characteristic of housing that contributes much to the problems that evolve as financial institutions attempt to deal with these critical issues in the lending decision. Once assembled, it is practically impossible to move housing more than a few feet. Consequently, it is an economic good whose value is often dictated by a



variety of external influences, having little to do with the actual edifice. The quality of the neighborhood; identity of the neighbors; and proximity to schools, work, and other desired services contributes as much to the determination of the value of housing as do conditions, size, and type of structure. This creates one of the most difficult problems for housing investment. Purchasers, sellers, and lenders are often unable to assess the true value of the property.

Homeowners, fearful of racial change in a neighborhood, sell at a lower than actual value. Rumors of the new location of facilities near-by drastically increase the value of housing. Confidence in a neighborhood's ability to maintain its character against external influences serves to maintain property values. The lack of ability to understand the many inputs into the value of housing results in the confusion of the buyer, lender, and seller; thus creating artificial barriers and influences in the housing market.

The remainder of this thesis will deal with the nature of financial institutions and some of the problems that have evolved around the flow of funds from them into the housing market. It is an attempt to understand the many artificial barriers and influences that have resulted from the policies and actions of these institutions.

Chapter II is a discussion of the inputs into the mortgage lending decision and possible results that these

might have on urban housing markets. There is a discussion of not only, the major types of financial institutions and their distinguishing characteristics, but also, the influences on the amount of available funds within these institutions for mortgages, and finally, the determinants of the lending decision and how they effect urban housing markets.

Chapter III deals with the roles of various thrift institutions in Boston's mortgage supply, based on an analysis of their portfolio policies from 1965 through 1972. The data offers interesting insights into the implications of the types of investments chosen, the sizes of the institutions, the nature of the charters (state vs. federal), and the role of the regulatory bodies.

Chapter IV is a case-study of the lending policies of one financial institution in Boston--The Dorchester Savings Bank. Data on the South Boston Savings Bank is also offered to help support some of the conclusions. The result is documentation of some of the practices such as "redlining" and support of absentee-owners which were introduced in Chapter II.

Chapter V draws conclusions about the issues that have been dealt with and offer suggestions for future action.

## CHAPTER II

## THE ROLE OF FINANCIAL INTERMEDIARIES

The supply of credit for housing is controlled by the actions of five major types of savings institutions. Three of these institutions are "depository" in nature—savings and loan associations, mutual savings banks, and commercial banks. In 1972 they accounted for almost 75 percent of all outstanding residential mortgages. The other two are the so called "contract savings institutions"—life insurance companies and retirement funds.(4) Together, these five institutions accounted for over \$350 billion in outstanding residential mortgage loans in 1972. Although they are not a significant supplier of funds for mortgages, mortgage companies are important because they originate and service many of the mortgages held by the other institutions. The following is a discussion of each of these five institutions, in order of the size of mortgage holdings.

### Savings and Loan Associations

The largest source of funds to the mortgage market comes from the more than 6,000 small, highly localized savings and loan associations,(5) whose primary purpose is to make mortgage loans and to promote home ownership.(6) Typically associations draw on savings from a relatively small geographic area and make loans within the immediate vicinity of the institution.(7)

In 1972 the total residential mortgage holdings

**TABLE 27 • Mortgage Loans Outstanding, by Type of Lender  
and Type of Property, Year-End 1972\***  
(Billions of Dollars)

Lender	Residential Properties			Commercial Properties	Farm Properties	Total Mortgage Loans
	One- to Four- Family	Multi- family	Total			
Savings and Loan Associations	\$165.9	\$21.2	\$187.1	\$ 19.2	†	\$206.4
Commercial Banks .....	55.7	6.1	61.8	31.8	\$ 5.6	99.2
Mutual Savings Banks .....	41.6	15.6	57.2	10.3	0.1	67.5
Life Insurance Companies ..	22.3	17.2	39.5	31.8	5.7	77.0
All Others .....	60.7	16.5	77.2	14.1	24.5	115.8
<b>Total .....</b>	<b>\$346.2</b>	<b>\$76.6</b>	<b>\$422.8</b>	<b>\$107.2</b>	<b>\$35.9</b>	<b>\$565.9</b>

Note: Components may not add to totals due to rounding.

\*Preliminary.

†Less than \$50 million.

Source: Federal Reserve Board.

Source: 1973 Savings and Loan Fact Book, p. 35

totaled \$187.1 billion, and it represented 85 percent of their total assets.(8) The reason for the large mortgage-to-asset ratio lies in the traditional charter requirements and federal tax laws, which dictate that the practical investments are real estate mortgages.(9)

These institutions are strong supporters of single family home financing. Three-fourths of their mortgage portfolios or 63.6 percent of their total assets are for loans on single family residences.(10)

Savings and loan associations do not actively use either the Federal Housing Administration or the Veterans Administration's programs to guarantee or to insure mortgage loans. As long as the demand from traditional borrowers is adequate, most associations will not invest in government-underwritten mortgages because of their lower return and lengthy processing time.(11) In 1972, 85 percent of all loans held by savings and loan associations were conventional. Even though the FHA insured and VA guaranteed loans were only 14.3 percent of the loan portfolio, they represented a marked increase from the 5 percent level that prevailed throughout the 1960's. Most of this increase can be traced to the purchase of loans rather than the making of new secured loans by the associations.(12) This results from recent rule changes by the Federal Home Loan Bank Board which allowed them to have 20 percent of their assets in out-of-state holdings. Most of these out-of-state holdings are FHA and VA loans purchased from the originators.

### Commercial Banks

The second largest suppliers of mortgage credit are the commercial banks, by far the largest financial intermediaries. Their role in the mortgage market is the most volatile because their greater investment flexibility coupled with the fact that a significant portion of their deposits are demand deposits, which are unsuitable for long term mortgage loans, has made them most responsive to changes in the money supply. Because of this, in recent years their relative position in the mortgage market has often shifted between second and third place in terms of the size of their total mortgage holdings.(13)

The crucial element in the banks' lending programs is the demand generated by the needs of its depositors and those of the local community. If these demands are not being met by other financial institutions, then commercial banks will step up their mortgage lending to meet the need, often at higher rates than those charged by thrift institutions. When mortgage funds are readily available they will, generally, funnel their assets into short term loans.(14) Consequently, only 12 percent of their assets are in mortgage loans.

Probably the most significant role of commercial banks in housing is not through the maintenance of a large portfolio of mortgages. Instead, they perform three vital services: (1) originating residential mortgages for sale to investors with servicing retained, (2) making construction loans, and (3) providing "warehousing" loan funds (used

to cover the loan from origination to sale in the secondary mortgage market) for mortgage banking companies.(15)

### Mutual Savings Banks

Like savings and loan associations, mutual savings banks were organized as thrift institutions. While savings and loan associations had a clearly defined purpose of using savings to promote home ownership, mutual savings banks were established with a goal of promoting savings, but for no set purpose.(16) Nevertheless, they are the third largest source of funds for housing with \$57.2 billion held in 1972. When the commercial banks reduce their activity in the mortgage market the relative position of mutual savings banks rises to second, just behind the savings and loan associations in importance.

Mutual savings banks are state chartered and, unlike savings and loan associations, are located in only 18 states.(17) The slightly more than 500 mutual savings banks are concentrated in the East, particularly in Massachusetts and New York (Massachusetts has 16 percent of all assets held by savings banks; New York, 55 percent).

Prior to 1950 mutual savings banks were local, or at most regional lenders. Consequently, because many mutual savings banks found relatively few desirable mortgages available, (particularly in the capital intensive East), the total mortgage holdings were a much smaller portion of assets than at present.(18)

In 1949 \$6.7 billion or 32 percent of the assets were



mortgage investments. By 1959 the total mortgage holdings were \$24.7 billion or 71 percent of assets. In 1969 the figures were \$55.7 billion or 75.2 percent of the total assets.(19) Several changes contributed to this steady increase in mortgage investment. The first was the introduction of out-of state mortgage lending legislation in 1950, which set the stage for a drastic change in portfolio make-up. Until that time mutual savings banks were allowed to make mortgage loans only on property within their immediate geographic area. Savings banks in the capital-intensive East often felt that there were not enough desirable mortgage investments in the local area to warrant a high mortgage component in the portfolio. This legislation allowed them to purchase mortgages from originators in other geographic areas. Consequently, they began to invest in mortgages in other areas of the country where there was a plentiful supply of low-risk, high-yield mortgages. By 1960 total out-of-state holdings had reached 35 percent of total mortgage holdings.(20) As a result, mutual savings banks became a significant force in the national mortgage market, often at the expense of local areas. When faced with a decision between an attractive loan in another state and a somewhat less attractive local loan, the out-of-state mortgage won. Almost all of the out-of-state loans were FHA or VA backed. The federal backing created a mortgage that could be traded sight unseen with a high degree of confidence. Today mutual savings banks are the largest

investors in FHA and VA loans, which account for slightly more than half of their mortgage portfolios.(21) Secondly, the yield on mortgages rose in relation to other possible investments, resulting in an increase in mortgage investment in all markets.

#### Life Insurance Companies

In recent years life insurance companies have been the fourth largest residential mortgage lenders, although it is not one of the purposes for which they were organized. Life insurance companies want to achieve the highest possible yields on the policy-holders' funds which they hold in reserve in anticipation of future payments of benefits. They enter into the mortgage market for the benefit of their policy-holders, not of the borrowers. Consequently, their entrance is dependent on the relationship between mortgage yields and yields on other types of investments.(22) When mortgages have a net return as high or higher than other possible investments, life insurance companies actively participate in the purchase and making of mortgages. When mortgage yield is low they reduce their activities in the market.

The general trend of lending by life insurance companies has taken the form of forward commitments for bulk purchases of single family mortgages. (23) Consequently, they play a relatively minor role in local mortgage markets—the channeling of funds via the purchase of loans often made and serviced by mortgage

banking concerns. During the late 1960's their holdings in one to four family residential mortgages declined while mortgages on large income-producing properties increased rapidly.(24)

#### Pension Funds

Pension funds have become increasingly important to the mortgage market in recent years due to their rapid growth. Their assets increased by \$48 billion (representing asset growth of 82 percent) between 1962 and 1967.(25) Their importance is not dictated by the size of their holdings as much as by the potential size of their holdings. Since the 1960's they have invested only 6 percent of their assets in mortgages.(26) Current government pressure for them to invest more actively in the mortgage market may result in an increase from the 6 percent level.

#### Mortgage Companies

Although mortgage companies do not actively maintain a portfolio of mortgages they, nevertheless, play an important role in the mortgage market. The primary purposes of mortgage companies are to serve as a financial intermediary bringing together the primary and secondary mortgage markets and the facilitation of the flow of funds from capital intensive areas to capital short areas.(27) Typically, the mortgage company negotiates a commitment for the purchase of large blocks of FHA and VA mortgages and, to a lesser extent, conventional mortgages from large financial institutions such as life insurance companies, mutual savings banks, and

savings and loan associations.(28) Besides the origination of the loan often the mortgage company also retains servicing of the mortgage for a fee which provides their major source of income. By making groups of mortgages to sell to investors, mortgage companies make possible large out-of-state investments by all financial institutions as well as providing the opportunity for institutions such as life insurance companies, who favor large investments, to invest in the residential market.

## THE FLOW OF FUNDS

Because the availability of financing is a major input into the housing market it is important to begin to understand the determinants of the flow of borrowed funds for housing sales and repairs.

The most important determinant of the amount of money available for housing is the flow of funds into thrift institutions. Since World War II, net gains in savings have been the major, although somewhat volatile, source of mortgage funds.(29) In general, they have provided almost half of the funds available for mortgages.(30) During times when the supply of savings is unpredictable or demands by other uses reduce the amount of funds available, flows into the mortgage market decrease. When the amount of savings rises rapidly, funds for mortgages increase, often beyond the immediate demand.(31)

The causes of the volatility of savings flow are rooted in the entire money market. As the supply of money is tightened, yields on investments other than savings accounts rise relative to the yields paid by thrift institutions whose maximum is set by law. Consequently, the investor often withdraws his funds from thrift institutions and reinvests in stocks, government bonds, and other types of investment instruments. This "disintermediation" has drastic effects on the availability of mortgages.(32) With less funds available, lenders must make fewer mortgages.

The second largest source of funds for mortgages is repayments on existing loans.(33) It was not until the latter half of the 1960's that this source of new funds became significant. Most mortgages are written with terms of 20 to 30 years, yet most portfolios turn over at a fairly steady rate, providing a constant stream of funds. This turnover is accomplished in three ways: first the payments on amortized principle; second, mortgage prepayments; and finally, loan liquidations which occur when mortgage property is sold.(34) In more recent years, the practice of selling originated mortgages to generate new funds has become increasingly popular with thrift institutions.(35)

The flow of funds from financial intermediaries is just as important as the flow of funds into these intermediary in determining the availability of mortgages. Like individual investors, most financial institutions have a choice as to investment possibilities. With the exception of savings and loan associations which are heavily regulated and to some extent mutual savings banks, although they are much less restricted than savings and loans, most financial institutions have no residential mortgage requirements. Consequently, when the yield on mortgages is less than that which is available on other permissible investments, institutions "disinvest" in mortgages transferring their funds to the higher yielding investments. This disinvestment includes selling

current holding in the secondary market therefore tying up other funds that might have gone into new mortgages as well as the reduction in the number of new mortgages made. This situation occurs when there is a "tight money" market causing other borrowers to bid up the cost of capital to a level above that which mortgage borrowers are willing to pay. This along with the general shortage of funds in thrift institutions due to disintermediation causes very little housing to be built during periods of tight money.

The money market is significant to housing not only because of its effects on the supply of mortgage funds, but also, for the effects it has on the cost of housing.(36)

Stringent money conditions result in an increase in the cost of financing. First, the cost of construction financing which is capitalized as a part of the unit cost, increases. The net effect is an increase in purchase price. Secondly, the cost of mortgage financing increases. The resulting increases in monthly payments cause certain housing to become too expensive for persons who could have afforded it under other monetary conditions.

For example, consider a mortgage for \$20,000 at 7 percent for thirty years. The monthly payment required to amortize the loan is \$132.33 and a person with an income of \$7940 could afford it. (Assume 20 percent of the income is reasonable for mortgage repayment.) If we raise the

interest rate to 9 percent, the required payment for amortization is \$159.83 and the necessary income of a person to afford the loan is \$9590. This analysis assumes a constant purchase price. More realistically, the purchase price would increase with a rise in interest costs resulting in an even more pronounced effect.

(In periods of drastic interest rises and severe shortages of mortgage funds however, purchase costs may in fact decline due to a drop in demand.)

Clearly, a significant number of people may be priced out of the market by the added costs of increased interest rates.



## THE LENDING DECISION

Most significant for this examination is the method of allocation of mortgage funds to particular borrowers. i.e. what are the inputs into the specific mortgage decision. The evaluation of risks involved is a crucial input into the mortgage decision. Lenders attempt to evaluate the risks associated with the use of the property as security for the loan as well as those associated with the borrower and his ability to repay the loan promptly.

The outcome of these segments of the risks analysis determines much of the nature of local housing markets. Persons who are determined to be bad credit risks cannot purchase new housing, nor can they repair housing that they already own. Often the net effect of this analysis is to deny access by the poor and often lower middle income inner city residents to decent housing. Secondly, housing that is determined to be a high risk property rarely can be bought, sold or repaired. This often results in a continuous spiral of neighborhood decay. Once an area is recognized by leaders as undesirable and declining the supply of funds disappears. The net result is further decay of the area and a decline in values because no one has an effective economic means to enable them to purchase housing within the area.

### Borrower Risk Analysis

The individual risk analysis is based on several determinations: first, the borrowers ability to repay

the loan (the basis of this determination is the potential borrower's income); second, the expectation of the continuation of that income; and third, the moral obligation of the borrower. If there is no history of long term job stability or if the applicant has only been employed for a few years the mortgage may be denied. The analysis of income is somewhat straight-forward with 20-25 percent of their income being available for housing. The key problem lies in the determination of what contributes to allowable income. Often income of women of childbearing age is discounted. Overtime income and other types of variable income are generally not counted. The American Savings and Loan Institute recommends that considerable attention be paid to the nature of the employment. e.g. unskilled workers are more apt to suffer layoffs than professional and government workers, and frequent job changes are, in general, undesirable.(37) The significant effect of these policies is to increase the difficulty of lower income families to obtain mortgage financing. Often their jobs are less permanent in nature than those of the upper income person. Spouse's income is as important to total family income as the husbands, if not more.

Not only must the borrower have the ability to pay, but he must also exhibit a degree of "moral obligation" towards the repayment of the loan. Lenders base this on past credit histories, often without bothering to examine in detail the reasons for apparent bad credit

reports. Because of the nature of their economic situations, minor monetary disasters often result in unfavorable credit reports for low and moderate income families. For example, consider a moderate income family who is suddenly faced with a large medical bill. One possible action that they might take is slow small payments until the bill is paid. Credit reports then find them to be "slow payers". Often the bill might have been turned over to a collection agency, resulting in a further decline in their credit rating, or if they borrowed money from a consumer finance company to pay the bill; that too, would have been shown unfavorably in the credit report as having to borrow to pay bills.

A conscientious, competent lending officer, who sincerely desired to effectively evaluate the risks involved, might discover this in the interview and interpret the credit report in light of it. More commonly, the loan would be declined because of an apparent lack of "moral obligation" to repay the loan.

#### Evaluation of the Property

More critical to lenders than the borrower's credit analysis is a determination of the risks involved in lending on the specific property, which provides the basis for the security of the loan in event of default.(38)

There are two major issues in the analysis of the property. First, the specific property is analyzed in terms of the characteristics of the site; the structural,

functional, and asthetic qualities of the building improvements; the rights and utilities included in the rproperty; and the relationships of the piece of property with the price of equivalent properties.(39) Just as important to the lending decision as the above analysis is an evaluation of the surrounding neighborhood. Questions of its stability, age, racial make-up, nature of its housing market (declining, stable or rising), and its general physical condition. Together these are used to acess a value to the property. The lender then bases, in part, his lending decision on this risk modified value. He wants to be assured that the difference between amount of loan and the appraised value of the property is sufficient to protect his investment.

Currently there are many problems with the delivery of mortgage services to lower income people of neighborhoods in the urban areas. Many of these problems have their roots in the ultraconservativeness and lack of expertise of lending officers.

The American Savings and Loan Institute, in its book, Lending Principles and Practices, has set the stage for this ultraconservatism and with following opening segment from the chapter on "Loan Evaluation":

The Associations first line of defense against lending loss is the selection of sound loans. In some associations the loan committee (the loan officers actually responsible for approving a loan application) occasionally ask the loan officer who recommended approval of an application under consideration to defend his recommendation.

The committee may even ask him if he would be willing to take over as mortgagee should the borrower turn out to be a poor credit risk. The question may be asked in jest, but it's a good one. It indicates the degree of care the loan officer must exercise in his loan evaluation role: He must act as if he were lending his own funds.(40)

This attitude towards the mortgage decision can only result in the lenders seeking to lend only in no risk situations. The effect of this is that only a few loans will be made in any but the safest suburban areas with rapidly rising markets. Masiel suggests that this attitude is a result of not only the basic conservatism but also the ignorance of many financial officers.(41) In fact, "the mortgage market tends to over compensate for its risks. Lenders who see lawyers and take proper precautions find that the high risk premium paid on most mortgages is much more than necessary to cover the actual loans involved."(42) While Maisel suggests that the "skilled mortgage officer does not attempt to avoid all risks," (43) we find that private institutions continue to be "extremely cautious about assuming the risks involved in loans in new areas, loans in new types of construction, loans to groups which have not had a long borrowing history, loans to blighted areas undergoing renewal, and loans of longer terms, or higher ratio than have been traditional in the industry."(44) A critical effect of their attitude is to deny access to homeownership to many lower income people in urban areas. More often than not, they require

higher loan to value ratios due to their inability to accumulate substantial down-payments, longer terms, lower monthly costs, loans to somewhat blighted areas because housing is often too expensive in other more desirable areas where the lender has not traditionally operated, and almost always loans to a group of people who have not had a long borrowing history.(i.e. those with lower incomes)

Often lenders continue conservative patterns of decision making even after there is no evidence to support them. An example of this occurred with the GI loan guarantee program. Many lending institutions have refused to make 100 per cent GI loans, even though they are guaranteed by the Veterans Administration for 50 to 60 per cent of the mortgage. The lenders feel that there is always a moral hazard associated with loans made where there is little or no equity on the part of the borrower. Even though the government offered a program to almost eliminate the risks involved, the conservative attitudes on the part of lenders kept them from taking part and as such greatly reduced the potential effectiveness of the government action. Even after evidence from those institutions who did make 100 per cent mortgages failed to support the fear of increased losses most institutions failed to modify their established lending policies.(45) What is clear is that although the government may act to reduce or remove the risks associated with "high risk" mortgages, it still may not be effective in changing the basic lending evaluation process and as such the

potential for opening up mortgage markets is drastically reduced.

Often the conservativeness and the apparent lack of expertise or willingness to develop expertise is manifest by the complete unwillingness of lenders to lend to certain neighborhoods.

Minority groups have often been written off as undesirable lending prospects by lending institutions. Consequently, home ownership for these groups has been almost an impossibility.

Often more crucial to urban housing problems has been the write-off of neighborhood or "red lining" as it is often called, because banks effectively draw a red line around an undesirable area and refuse to write mortgages within the line. Although denied by many lenders, Henry E. Hoagland and Leo D. Stone, in their text, Real Estate Finance, have described the process of red lining well.

... In many instances their (lenders) general knowledge of their potential markets is such that they can visualize the neighborhood influences for good or ill as soon as the address of the property is given them... using an ordinary map of the city in which they operate, they may outline the most desirable part of the city in which they operate in one color-- perhaps green. Blue may designate areas that are still good but have passed their peak values. Yellow may designate declining areas that are on the downgrade. Here we find older neighborhoods with obsolete properties, many of which show evidences of neglect! Red spots on the map are danger signs. Absentee ownership and blights of one kind or another have left unmistakable marks in the heavy risks assumed by those who finance properties in such areas. (Emphasis added) (46)

"Redlining" is referred to in not only the mortgage and real estate literature, but also by authors such as Jane Jacobs. In her book, Death and Life of Great American Cities, (47) she talks about a "Credit Black-listing" in the Italian North End of Boston. No Boston bank would make mortgage loans on property in the North End. Had there not been a unified effort on the part of the Italian residents of the area to provide both money for purchase and rehabilitation (along with a co-operative labor venture for the rehabilitation), the area might have decayed to a level of abandonment and disrepair rather than becoming the viable neighborhood that it is today.

A study of the lending policies of Chicago area savings and loan associations indicates that there is significant disinvestment in the inner city as well as redlining in the older city neighborhoods.(48) The result has been accelerating neighborhood decay and a reduction in the cities population-- the middle class is being driven from the city due to decay which is aggravated by the lack of rehabilitation loans and the unavailability of adequate financing for home ownership.

This refusal of the lenders to sink money into areas that they believe are declining is a self-fulfilling prophecy. When the flow of money for rehabilitation and home ownership loans in an area is drastically reduced, there is a resulting decline in both the physical



quality of the buildings as well as the effective desirability of the neighborhood. Because of these major effects, "redlining" is the most detrimental of all banking policies on the inner city and at the same time it is the most difficult to prove. Banking regulations do not require that banks report information on the geographic location of their investments. A recent article in the Wall Street Journal suggests that

(W)here data can be gathered, however, the pattern seems clear--lenders are anxious to put more money in the newer suburbs where risk is minimized, even though a large percentage of their assets may still come from the inner city.(49)

Although not currently illegal actions such as these, which have such serious consequences, are irresponsible on the part of the lending institution.

## ABSENTEE OWNERSHIP

Often it is just as important who a bank lends to in an inner city neighborhood as to whether they lend at all. Many institutions find it easier to make mortgage loans to an absentee owner who has a past history of mortgages, resulting in easier credit analysis, and who often borrows larger amounts creating a fairly significant amount of mortgage business. The consequences of an institution making the easier choice and lending to an absentee owner are often drastic to the neighborhood.

It is common for absentee owners to buy property in particular neighborhoods with the purpose of making larger profits at the cost of neighborhood decline and sometimes complete destruction. The first method by which these profits are extracted is speculation. The absentee owner purchases a property at a price which may be above the present market price in anticipation of a substantial profit either from increased rents or resale in the near future. Generally, this occurs in areas where there is an anticipated increase in demand such as the area surrounding the new University of Massachusetts campus in Boston. The net effect is often to make housing in the area too expensive for resident owners.

Secondly, they engage in "Slumlordism." Here the investor accelerates the decay of buildings through inadequate maintenance and repair. The funds normally

allocated to those services are taken as profits by the owner who is interested in the short term return. The net effect is a serious deterioration in the physical quality in the neighborhood.

Often lenders will lend to absentee owners in areas where they normally would lend to a resident owner. The secure credit history of the absentee assures them that the risks of foreclosure are minimal and therefore the property risks are of little importance.

Lenders support absentee owners in other ways. They give them higher loan to value ratio mortgages, often exceeding the purchase price of the property. They develop a relationship with large absentee owners, insuring very little "red tape" in the mortgage application and approval process. All of these make absentee ownership an easier and more desirable activity. Lenders who support such activity do so not as a local neighborhood institution concerned about the quality of life in the area which it serves, but as a large financial institution only concerned about making a profit on its investments.

## SUMMARY

Of all the institutions playing major roles in the mortgage market, only savings and loan associations were founded with the expressed purpose of promoting home ownership. The others enter the market as a result of the traditionally high yield offered by mortgages and/or as a service to their depositors who are unable to attain a mortgage from other sources. In addition to purposes set forth in original charters of these institutions, regulations have been put forth that limit the scopes of their investments to certain areas. The combination of purpose with regulations is significant in determining the precise role of these institutions in the market.

Savings and loan associations with their goal of promoting home ownership and tight regulations both in terms of investment types and geographic restrictions have a very large portion of their assets in single family loans. Because of this strong support of single family resident owned mortgages, savings and loan associations are the most important of all financial institutions in the housing market. Although limited, their contact with lower income residential areas is greater than most other financial institutions.(50) This stems from a more conservative attitude on the part of banks and other financial institutions toward home mortgages as well as a general policy by savings and loan associations to

make mortgages on smaller, less expensive homes.(51) Even so, their role may not have always been commendable and, in fact, in many cases it may have contributed to a strong degree of neighborhood decline.(52) Marvell suggests that they have often been prime supporters of the middle class exodus from the central city into the suburbs.(53) Even when they do enter into the inner city housing market, he suggests that it is often only to support the large absentee landlords rather than the resident owners for which they were founded.(54) The unwillingness of savings and loan associations to utilize the FHA programs has resulted in them making few loans on low and moderate income housing in the city since it must often be insured by FHA to overcome traditional risk analysis. These policies of savings and loan associations may have resulted in anything but support of the inner city neighborhood.

Commercial banks, because of their preference for short-term loans to businesses and individual customers have entered the mortgage market only when other financial institutions were not satisfying the mortgage needs of their regular customers. Although they are the second largest lender in the mortgage market, their holdings represent only a small portion of their total assets. Their activity is most pronounced in smaller capital-short cities and towns. In large metropolitan areas that have a strong supply of capital they tend not to be actively involved in the mortgage market. Consequently, they are

less important to the analysis of inner city housing markets.

Mutual savings banks, in recent years, have actively invested in mortgages because of their relatively high yield compared with other types of allowable investments. They are significant purchasers of large blocks of mortgages from originators, particularly in other areas of the country. Many of the residential mortgages that they have originated are for large income-producing properties. They do not see the promotion of home ownership as a major goal.

They are significant in housing markets where they are located, not only because of the mortgages they make in that area but also because of mortgages that they hold in other areas. Most, if not all, of their funds come from the local area. Any investment of funds in other areas of the country before the needs of the local area have been fulfilled is not in the best interest of the local area. In the areas that have mutual savings banks they often play an extremely important role in the local savings market. In fact, they are often the largest potential supplier of mortgage funds in an area. If they do not attempt to meet certain local needs, often these needs cannot be satisfied. Consequently, the lending policies particularly those towards investment in areas other than the local area are of crucial importance.

Currently the lending decision is composed of the

analysis of both the borrower and the property. Both analyses tend to make use of practices that are more conservative than need be. (e.g. often inner city residents must spend 30 and even 35 percent of their income to obtain decent rental housing, yet lending officers still use a 20 to 25 percent figure to determine the amount of money available for housing. No allowance for the fact that a much larger amount was reasonable in terms of the family budget in the past is made.) In fact, the lack of expertise on the part of the lender often results in a failure to approve a loan when more realistic methods of risk analysis might indicate that the loan, although having some elements of risk, is nevertheless a sound one.

Before the needs of many potential borrowers who are now denied mortgages can be met, lenders must develop a more precise methodology of risk analysis. Lending officers in the inner city must develop an expertise in dealing with the problems of the inner city resident. They must discard many of the old concepts associated with older urban neighborhoods and replace them with an open mind so that they might evaluate real risks instead of perceived risks. Chase has suggested that inner city lenders should weigh the evaluation of the borrower more heavily than that of the property. (Traditionally, the property was most important because the property served as the lenders protection in the event of fore-

closure.)(55) But in doing so, he must reject some of the old evaluation techniques and replace them with a more human, and at the same time more difficult to utilize, set of criteria. He must be willing to probe into the reason behind apparent bad credit indications and interpret those in light of his findings.

In short, the lender should be willing to take an aggressive role in inner city lending. His obligations to do this is not a legal one, but rather is a moral one towards the area where his deposits come from. He must develop the required new methodology as well as setting policy directives towards reinvestment in the inner city.

This section has discussed many of the problems and issues around the flow of funds from the private saver, through the "financial intermediaries", and finally into the mortgage supply. As we have seen, the role of the financial institutions is one of the most crucial in this process. The remainder of this thesis is an attempt to look at the role that these institutions play in one local housing market. We will look at the city of Boston and the institutions operating there, and in more detail examine one of those institutions—the Dorchester Savings Bank—and its activities in one of the neighborhoods in Boston.

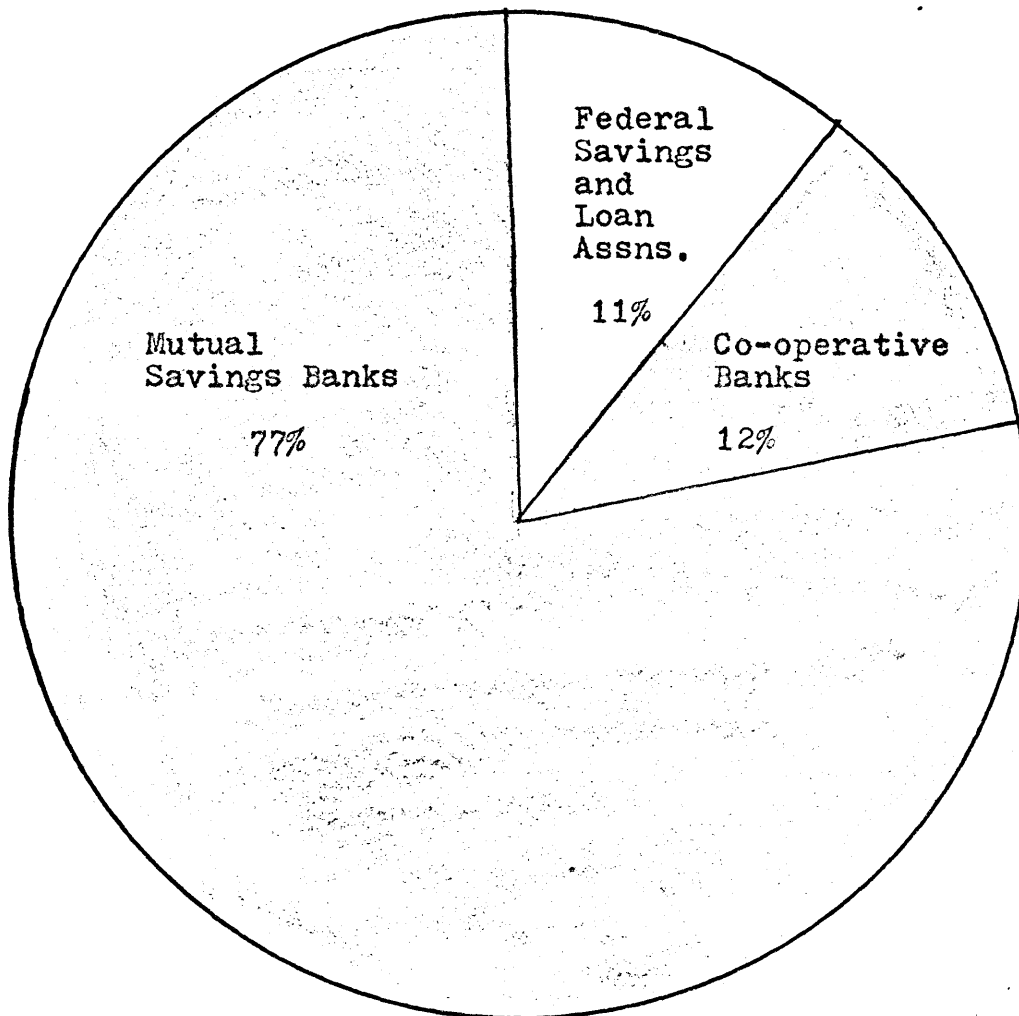


## CHAPTER III

## THE BOSTON SITUATION

Thrift institutions, traditionally, have played a major role in the housing marketplace. Boston has been no exception to this. Three major types of thrift institutions are present in Boston: The state-chartered savings banks and co-operative banks and the federally chartered savings and loans. (See Chart 1 for the relative size of their mortgage holdings.) The co-operative banks are the equivalent of state-chartered savings and loan associations in Massachusetts. The importance that these institutions gain from the dependence of the housing market upon their financial resources causes any investment policies that they have to be significant. Analysis of the portfolio policy as determined by the annual reports of the thrift institutions has given considerable insight into some important trends dealing with the relative size of institutions, in-state vs. out-of-state investments, and variances in individual institutions' willingness to invest in certain types of assets. (56)

The current trend towards domination of financial markets by a limited number of large institutions is clearly evidenced by an examination of Boston-based lending institutions. One half of the savings banks in Boston have more than 90 percent of the total combined assets of all Boston savings banks. (See Chart 2.) These institutions also account for 26 percent of the assets held by the 171 savings banks in Massachusetts. The co-operative bank situation is much the same. Twelve

CHART 1

This graph depicts the relative size of the mortgage holdings of the major types of thrift institutions in Boston. The shaded area depicts those holdings that in state-regulated institutions. The unshaded area represents those holdings in federally chartered and controlled institutions. (1972) Total assets in mortgages are \$3803 million.

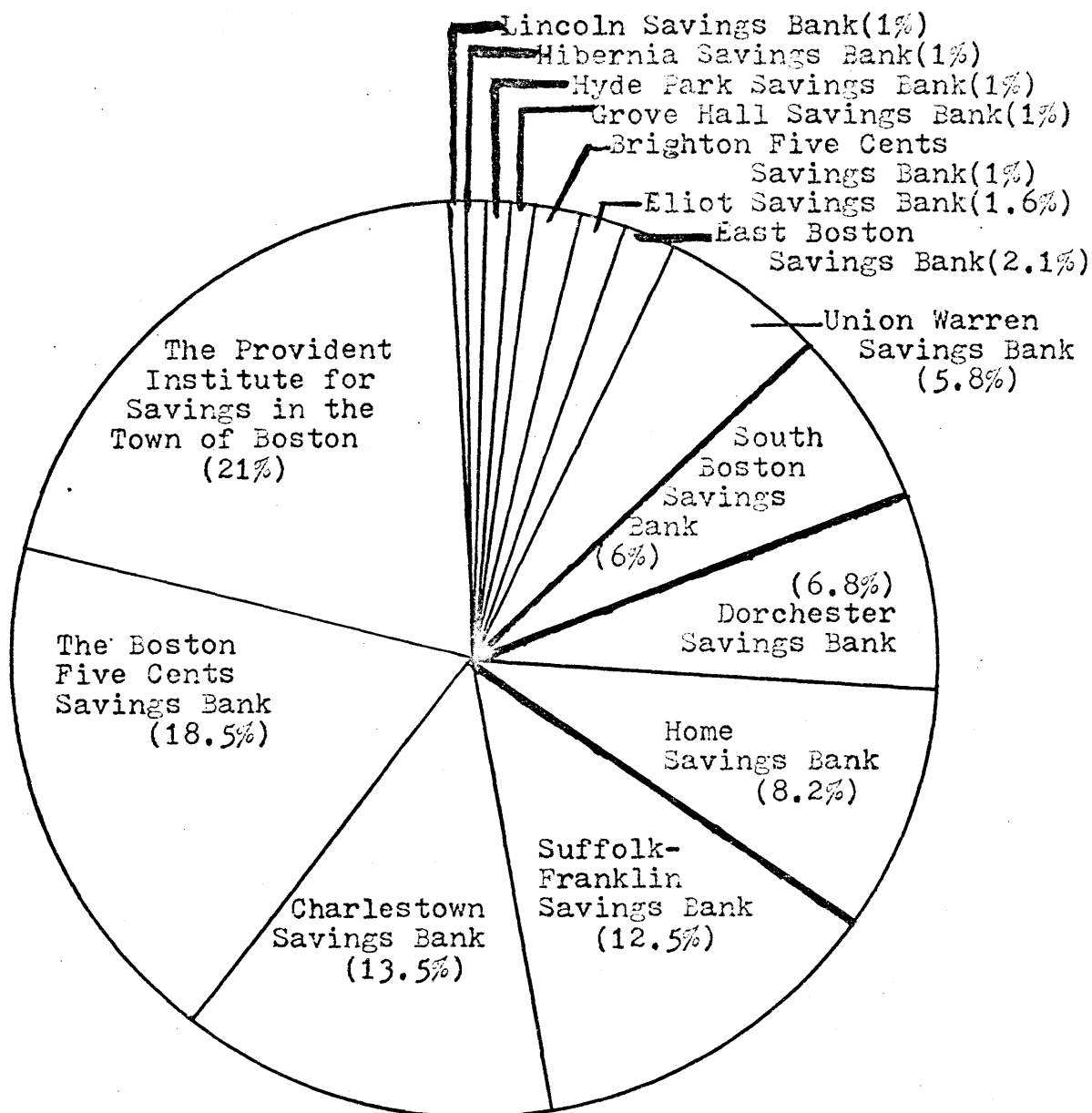


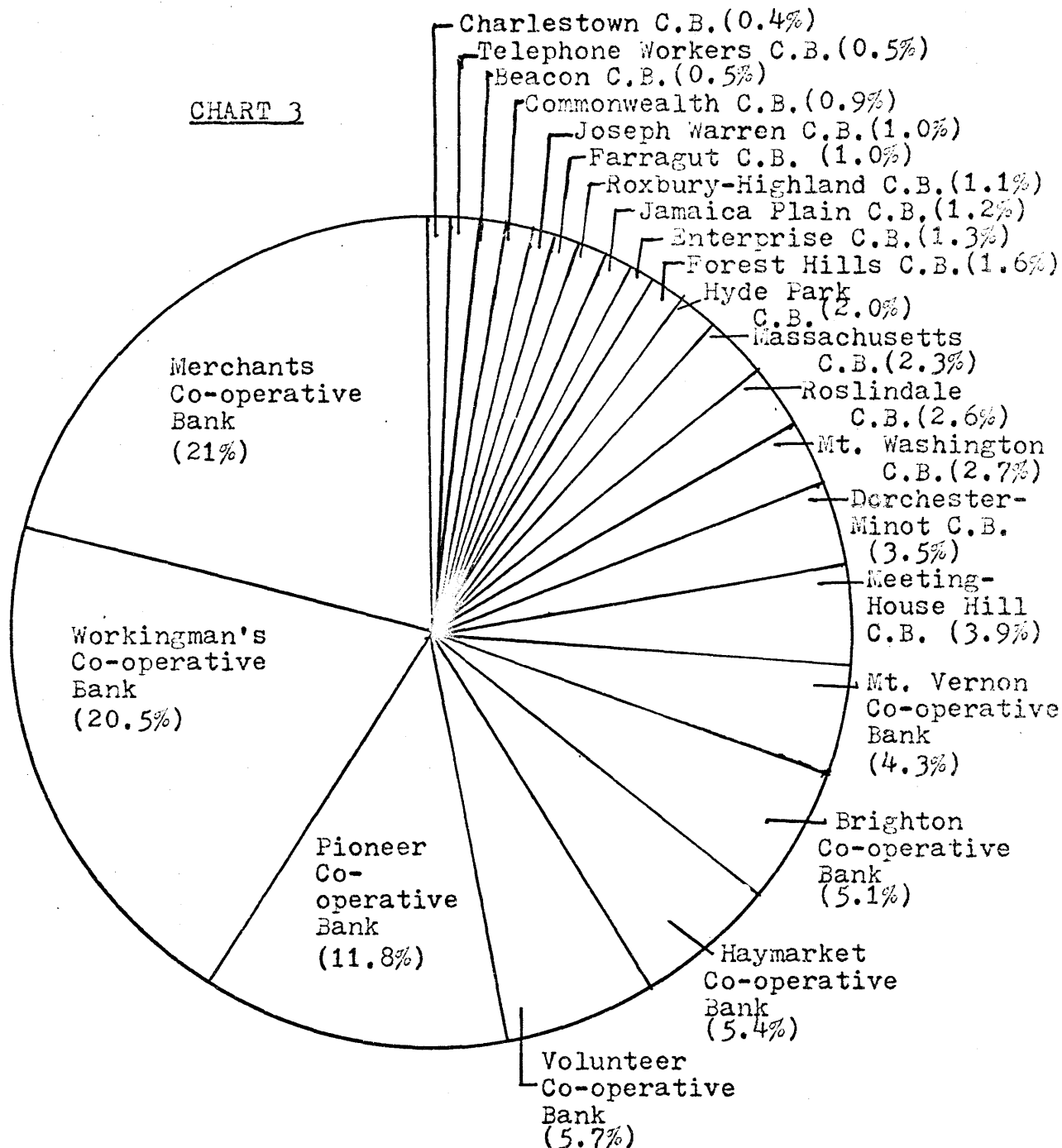
CHART 2

This graph depicts the relative size of the assets of Savings Banks located in Boston. The numbers in parentheses indicate the actual percentage of the total assets of all savings banks in Boston that the particular bank accounts for. Total assets are \$4084.2 million. (1971)

of the twenty-three co-operatives in Boston control 85 percent of the total assets of all Boston-based co-operatives. (See Chart 3.) Federal savings and loan associations in the city follow the same pattern with one half of the federal savings and loan associations controlling 86 percent of the outstanding mortgage loans held by all Boston-based savings and loans.

This phenomena is present in a more dramatic form. The eight largest savings banks in Boston (out of 16) have 67 percent of the combined real estate mortgages held by Boston-based savings banks, co-operative banks, and federal savings and loan associations. It is the policies of these few banks that determine much of the nature of mortgage availability in Boston. Only 48 percent of their assets are held in in-state mortgages. Clearly, this group of institutions should be one of the main targets of efforts in the mortgage market. These banks have had a more aggressive investment pattern than many of the smaller institutions. This aggressive policy causes them to be more responsive to the economy as they choose investments. Since 1965 they have tended towards more liquid investments such as bonds, government obligations, FHA and VA insured mortgages, notes and personal loans, rather than long term conventional mortgages. One possible outcome of this could be a shortage of conventional monies resulting in a disproportionately applied limitation on the number of conventional loans being given to lower

CHART 3



This graph depicts the relationship between the assets of all Boston-based co-operative banks and the assets of each individual bank. The data is from 1972. Note that the numbers in parentheses are the actual percentage of the total assets that each bank accounts for. Total assets are \$595.3 million.

income as well as to minority members, who are often at the bottom of the opportunity scale.

It can be speculated that the larger institutions are more aggressive in their portfolio investments because they are more skilled in profit maximization. They do tend to invest in a greater variety of assets as well as varying from the norm in terms of levels of investments in particular assets. They not only invest in the tried and true real estate mortgages but also in bonds, government securities, stock in other financial institutions, and even bonds and notes that are not to be used to satisfy legal reserve requirements. It is clear that the only reason for the latter investment is profit. Even in their real estate portfolio they experiment with various combinations of the possible types of loans available to them as they attempt to maximize profits. The co-operative banks are a particularly good example of this. The two largest co-operative banks account for 41 per cent of the combined assets of all co-operatives in Boston. Yet they have 88 per cent of the combined total of co-operative investments that are not legal for reserves, 90 percent of the combined investment in other bank stock by co-operatives, 69 per cent of the investments other than mortgages held by co-operatives, and slightly less than 38 per cent of the real estate mortgages held by co-operatives.

One would expect that the largest institutions would

be best suited for the making of low downpayment mortgages. The skills of their staffs should be well suited to some of the special problems associated with evaluating and making low downpayment mortgages. Although there is no appreciable increase in risks with a low downpayment mortgage (the part of the mortgages above the standard percentage (80%) must be insured) banks often cite "risk" as the reason for their undesirability. The diversified asset portfolio of the larger banks should allow them to absorb any increase in risks with relative ease. This does not appear to be happening. The two largest co-operative banks make almost no 90 per cent mortgages while many of the smaller co-operatives have 5-10 per cent of assets in this type of loan. Often it is only through this type of loan that a low income family has access to homeownership. Lending institutions which fail to make these types of mortgages are, in fact, preventing the reality of homeownership for people with limited incomes who cannot acquire a substantial amount of cash for a downpayment.

Out-of-state FHA and VA loans play an important part in the portfolios of the large institutions. Because out-of-state loans are purchased from a maker in another state the lender becomes an investor who invests in this riskless mortgages without having to evaluate them on an individual basis. He becomes less of a mortgage maker and more of a financial investor seeking



the highest yield on his investment. The selection criteria becomes one of only yield since the government backing removes the question of risks. The three largest savings banks account for 52 per cent of the combined assets of all Boston-based savings banks, yet they have 62 per cent of the out-of-state loans and 42 per cent of the in-state loans held by savings banks in Boston. Any continuation of a trend towards increased investment in this area would have very serious consequences on the mortgage market in Boston. The first result would be a fund drain. i.e. Money invested in Boston would supply mortgages in other states at the expense of Boston residents. Secondly, financial institutions could move out of the mortgage market entirely, being content merely to purchase and sell mortgages much as they would any other type of liquid asset. "Mortgage brokers" might become much more common. It is possible that these new mortgage makers might be much more conservative than financial institutions have been as they seek the highest return on their investment.

One of the most significant findings of this analysis was the extent to which state-chartered institutions dominate the savings and , consequently, mortgage market. 89 percent of the mortgages held by , Boston-based thrift institutions are in state-chartered institutions. Statewide, 75 percent of mortgages are held by state-chartered institutions. This is extremely different

from the situation in most areas of the country where federally chartered savings and loan associations tend to dominate the market.

This situation has a very important implication. There is a shift in the level of regulatory action from the national to the state and local level. Changes in Boston's situation must be accomplished through changes in state law and state regulatory policy. Consequently, national movements to change federal laws and regulations often have only marginal implications for Massachusetts. Their greatest effect is to set precedents for actions at the state level in Massachusetts. This state-dominance of thrift institutions offers Massachusetts an as yet untapped opportunity to solve many of the problems in the local mortgage market without having to wait for the federal government to act.

## CHAPTER IV

## DORCHESTER SAVINGS BANK—AN ANALYSIS

Introduction

The Dorchester Savings Bank is the seventh largest thrift institution in Boston with total assets well over \$260 million. Critical to the importance of this institution is the fact that it plays a major, if not the major, role in the mortgage market in the Dorchester area of Boston.

Dorchester is a basic white working-class community located on the edges or in the path of the expanding black residential community. Its problems are typically those of the inner-city neighborhood. Areas of Dorchester are experiencing residential decline brought on by inadequacies in the housing market, absentee-ownership, and racial blockbusting. The purpose of this analysis is to examine the role of the Dorchester Savings Bank in the housing market and to understand how this particular bank helps or hinders the neighborhood decay through its lending policies.

Two sources of data were used in this analysis. The first was the Annual Report of the Commissioner of Banks. The second was information from the Suffolk County Registry of Deeds. The information used included the identity of the mortgagee and the mortgagor, the amount of the mortgage, the sales price (if there was a sale), whether the loan was FHA or VA insured or guaranteed, and the address of the property as well as that of the mortgagor (from this information it could be determined which properties were absentee-

owned and which had resident-owners).

#### Level of Mortgage Lending

The Dorchester Savings Bank has long been a supporter of the mortgage market. Three-fourths of its assets are in real estate mortgage loans. 85 percent of those mortgages (63 percent of total assets) are in in-state holdings. These figures have remained constant throughout the growth period from 1965 through 1971 and have continued through the present time. Clearly, the Dorchester Savings Bank views the mortgage loan as the most viable and desirable of permitted investments. In this respect, it is a strong supporter of housing markets. However, there are other important considerations: 1) where the mortgaged properties are located, 2) the identities of the mortgagors, 3) the terms of the mortgages, and 4) the types of mortgages. All of these contribute to an understanding of the role a particular institution plays in the mortgage market.

Table 1 offers many insights into the operation of the Dorchester Savings Bank between 1970 and 1973. Most important is the constant level of mortgage lending to resident-owners in Dorchester. Even though the total mortgage lending within the city of Boston varied from a high of \$11.4 million in 1972 to a low of \$3.1 million in 1970, the level of resident-owner mortgages in Dorchester remained constant at \$1.6 million. This suggests that the bank has predetermined a level of lending for mortgages to resident-owners that is free of influences made by changes

TABLE 1

DORCHESTER SAVINGS BANK—LENDING LEVELS 1970-1973  
(in millions)

RESIDENT-OWNER MORTGAGES

<u>AREA</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>
Dorchester	1.6	1.6	1.6	1.6
Boston-core	0.0	.25	.26	.3
Other areas of Boston	.95	.75	.65	1.46
Total	2.55	2.6	2.51	3.36

ABSENTEE-OWNER MORTGAGES

Dorchester	.46	1.55	.7	.5
Boston-core	.02	2.55	6.8	2.3
Other areas of Boston	.09	.09	1.34	.3
Total	.57	4.19	8.84	3.1

Total lending level	3.12	6.79	11.35	6.46
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in the market demand. One might call this a "public relations level". Lending less than this level could leave the bank particularly vulnerable to criticism that it was, in fact, carrying out a policy of disinvestment within Dorchester—a situation no officer of the bank would like to have to defend. There is no need to lend above this level since the banks underlying motivation is to provide an out in the face of criticism—a task reasonably accomplished by lending at the preset level. After it achieves this level, the institution is free to invest in mortgages in other areas where risks are lower or easier to analyze and/or there is a chance for a greater return.

Analysis of the lending patterns of the South Boston Savings Bank tend to support these findings. The South Boston Savings Bank has approximately the same asset size and experienced much the same level of growth throughout the period examined. Table 2 indicates that this institution has followed a pattern very much like that of the Dorchester Savings Bank. It too, lends approximately \$1.6 million to resident-owners in the local area (South Boston, in this case). This clearly supports the argument for a predetermined "public relations" level of mortgage lending to resident-owners in the local area.

The current level of investment in Dorchester for resident-owner mortgages is slightly greater than .5 percent of total assets per year. If the portfolio turns over every 10 years (it may even be much shorter) and the level of

TABLE 2

SOUTH BOSTON SAVINGS BANK--LENDING LEVELS 1971-1973  
(in millions)

RESIDENT-OWNER MORTGAGES

	1971	1972	1973
South Boston	1.4	1.6	1.6
Dorchester	.87	.47	.39
Boston-core	.06	.02	0.0
Other areas of Boston	.28	.17	.34
Total	2.61	2.26	2.33

ABSENTEE-OWNER MORTGAGES

South Boston	1.16	4.48	1.97
Dorchester	.65	.57	.28
Boston-core	7.18	4.71	2.99
Other areas of Boston	.44	.4	.11
Total	9.43	10.16	5.35
Total lending level	12.04	12.42	7.68



investment in Dorchester remains constant, at most, 6 percent of the assets of the Dorchester Savings Bank will be resident-owner mortgages in Dorchester. This is certainly not a commendable level of support for a neighborhood that has actively supported a thrift institution through most of its existence, unless the mortgage demand in that area is satiated. If we are to believe the statements of various community groups like the Codman Square Civic Association, It is clear that there has been no satiation of demand in Dorchester.

There are several very important implications of this policy. The first is that changes in the demand for mortgages in the Dorchester area may not be coupled with a corresponding change in supply (if the change is towards increased demand), at least with respect to the Dorchester Savings Bank. Governmental attempts to make mortgages less risky in Dorchester may, at most, have marginal effects. And finally, an increase in the amount of money available for investment may not necessarily be manifest by an increase in mortgages on resident-owned property in Dorchester.

This same sort of commitment level tends to hold for all resident-owned investments within the city. The total mortgage level on these types of properties has remained at or near \$2.5 million from 1970 through 1972. The larger investment in 1973 is due, in part, to a significant number of condominium mortgages that were the result of a prior commitment to a large developer. Consequently, the increase

in 1973 is less a product of their internal lending policies and more a result of the developers sales ability. Examination of South Boston Savings Bank's lending levels again support the theory of a predetermined level.(see Table 2) South Boston Savings Bank has a level of resident-owner lending in the entire city that is very near the \$2.5 million figure established by the Dorchester Savings Bank.

It appears that changes in the level of available funds are manifest in changes in the level of absentee commitment. Consequently, efforts to increase the supply of mortgage funds available to this bank may do little for the problems of the resident-owner while providing significant support for large absentee-owners.

Many areas of Dorchester are particularly ripe for the various roles of the unscrupulous absentee-owner. The opening of the new University of Massachusetts campus, with its influx of students and employees into the area, has created a perfect environment for the speculator who buys local property at inflated prices, hoping to make large, quick profits either through resale or increased rents. This occurs because the demand in such an area increases at a much faster rate than the relatively stable supply and, as a consequence, drives the prices up. Secondly, there are areas where "slumlords" are beginning to take their tolls, bleeding the buildings and then abandoning them. Finally, the racial blockbuster finds the fringes of the expanding black population the perfect location for his

activities. The actions of any of these and even those of the more scrupulous absentee-owners often result in severe neighborhood decline. Support of these activities by financial institutions is an irresponsible action with many severe repercussions on the local housing market. Most important is the effect of the increased decay on mortgage availability in the area. Lenders often support absenteeism in an area and then refuse to make new mortgage loans in the same area at a later date, citing increased risks caused by neighborhood decay as the reason for their action.

While it was relatively impossible to determine whether any of the mortgages made by the Dorchester Savings Bank actually supported any of the above activities, it was possible to determine whether a particular mortgage was made to an absentee-owner or not. The result was some idea of the level and type of support given absentee-owners. From Table 1 it is clear that there is an active support of absenteeism in the city. As could be expected, the largest level of support occurs in the Downtown-Back Bay-South End area of the Boston-core where most housing is absentee-owned. The support of absenteeism in Dorchester, although significant, is generally much less. Not only was there evidence of this support in the total dollar amounts, but also in the terms of the mortgages.

It was not uncommon for an absentee-owner to receive a mortgage loan equal to or greater than 100 percent of the

purchase price. This almost never happened to resident-owners. Because of such actions, an absentee-owner can purchase a property for \$10,000 and receive a mortgage loan for \$15,000. Consequently, he gains title to the property and almost \$5000 in cash without having to risk any of his own money, or for that matter to have any money of his own. This crucial type of support gives the absentee-owner an incredible degree of leverage, allowing him to expand at a much more rapid rate than if he had to finance significant portions of his purchases with equity capital. (Note that these are not mortgages for 150 percent of value which are illegal, instead they are the result of the absentee-owner's purchase at a ridiculously low price or receiving an unrealistically high appraisal for the mortgage basis. It is interesting to note that only the absentee-owner seems to be able to purchase at such bargain prices or receive such inflated appraisals.)

Support of absentee-owners coupled with a limited level of support for the resident-owner is indicative of the support of neighborhood decay by an institution. Dorchester Savings Bank, although to a much lesser degree than it might, clearly support the forces that foster decline in Dorchester's housing stock. It has set moderate limits on the amount of resident-owner mortgage funds and at the same time supported absentee-owners to a moderate degree in Dorchester. However, it is not only important how much money an institution allocates to absentee-owners, but also

which absentee-owners it supports. Dorchester Savings Bank's record has not been totally perfect in this respect. An example of this is in its support of Michael F. Kenealy of Milton. Kenealy controls as many as ten realty trusts in Dorchester.(57) Mortgages for 100 percent of purchase price and more were made to Mijo Realty Trust, Kenco Realty Trust and Michael F. Kenealy, all names under which Kenealy operates. The Dorchester Community News has printed a series of articles exposing Kenealy's unscrupulous practices of speculation and racial blockbusting in Dorchester.(58) They feel very strongly that he poses a serious threat to any neighborhood in which he operates. The support of Kenealy by the Dorchester Savings Bank is the support of absenteeism at its lowest and most devastating level.

### Redlining

Just as crucial as support of absenteeism in an area is the presence or absence of the bank policy of "redlining". Here the lender draws a line around an area and refuses to make mortgage loans within the line. The result is complete destruction of the housing market within the area. No housing can be bought, sold, or repaired due to the lack of mortgage funds.

Maps 1, 2, and 3 illustrate the geographic location of properties mortgaged to the Dorchester Savings Bank during each of the years from 1971 through 1973. These are represented by dark-colored dots. The large shaded area on the maps represents that part of Boston with a population that is over 50 percent Black.





**MAP 1.** Location of the properties within the City of Boston mortgaged to the Dorchester Savings Bank in 1971. The shaded area has a predominately black population.





MAP 2. Location of the properties within the City of Boston mortgaged to the Dorchester Savings Bank in 1972. The shaded area has a predominately black population.





**MAP 3.** Location of the properties within the City of Boston mortgaged to the Dorchester Savings Bank in 1973. The shaded area has a predominately black population.



Very few mortgages have been made by the Dorchester Savings Bank in the predominately black area. While a large portion of the shaded area (most of the lower half) lies in or very near Dorchester, this bank has continued to make almost no mortgages within that area. At the same time the bank has made many mortgage loans in other sections of Dorchester, often just outside the boundaries of the predominately black populated area. This practice appears to become more pronounced in each successive year. It appears that the Dorchester Savings Bank has, in fact, "redlined" the area. This is the most devastating action that a lender can take with respect to an area. If other institutions follow these same policies, this community is destined to continued decline. Without money, there is very little that can be done to maintain the housing stock in the neighborhood. It is these actions by the Dorchester Savings Bank that are most threatening to the continued neighborhood viability in all of Dorchester. As one neighborhood declines, so must those immediately adjacent to it.

#### Branch Banking

The strength of the Dorchester Savings Bank is evidenced by its rapid growth in the late 1960's. In the period between 1967 and 1971 the assets of the Dorchester Savings Bank grew from \$130 million to \$250 million (or 92 percent), a rate of growth unmatched by any other Boston thrift institution during this period. The rate of growth declined to \$12 million in the next two years. The more rapid growth was due, in

part, to an introduction of branch banking activities in the downtown area of Boston and to the transfer of \$50 million in assets in conjunction with the merger of the Dorchester Savings Bank and the Wildey Savings Bank. The first downtown branch of the Dorchester was originally the office of the Wildey Savings Bank. It is possible that the desire to move into the downtown market was instrumental in the merger decision.

This growth of branch banking has critical implications on the bank's role in Dorchester. It is common for neighborhood thrift institutions in older urban areas to open branches in the newer, more affluent areas of the city or suburbs. These actions may be at the expense of the residents in the older areas which gave them much of their economic viability in earlier years. Not only do they open branches, but occasionally they transfer the main branch to the newer area. A clear example of this is Boston is the Charlestown Savings Bank. It was founded in Charlestown in the 1850's. In 1951 it opened a branch in the downtown and eventually moved its main office to that location. Currently, it has eleven offices with only one in Charlestown. In some cases, thrift institutions have the power to close down the original office in the older declining areas, leaving the residents without the services of a local thrift institution.(59) Even when they do not go to these extremes, branching may not serve the best interests of the older neighborhoods. Although there is very little conclusive data, it has been suggested

that in many cases branching may facilitate the flow of funds from the older, declining neighborhoods to the newer, more viable areas.(60) It does this in two ways. First, it provides easier access to the mortgage demand in the "more desirable" lending area. Persons seeking a loan initially check with those institutions where he is a depositor and then those institutions with branches in the neighborhood where the property is located. In this manner, branch banking increases the demand for an institutions available mortgage funds by those areas where risks are often lowest. Secondly, branch banking may foster the weakening of ties with an institutions original neighborhood. There is no longer a dependence on the old area for the institution's viability. The new areas may, in fact, be the source of the majority of new deposit growth. As a consequence, the institution is forced to change its loyalties. The institution is such a situation, no longer dependent upon the old area for economic strength, is free to act in a manner that does anything but support its former lending area. It no longer has to be afraid of policies that might result in neighborhood decay. In short, the ability to branch may have given financial institutions the opportunity to ply the trade of the absentee landlord, "bleeding" the area for all its worth and then abandoning it.

It is difficult to draw hard conclusions about the role of branch banking in the operation of the Dorchester Savings Bank. There is no information available concerning the

the location of depositors. Nor is there any easily assessable data on the location of all mortgage loans made by Dorchester Savings Bank. The data presented in the earlier parts of this analysis tend to indicate that, while not overwhelmingly positive, the effects of branching have been much less drastic than those hypothesized. While there has not been a wholesale write-off of the Dorchester neighborhoods, it does appear that certain areas (mostly those with large black populations) have been neglected. The mortgage needs of the entire neighborhood are not being satisfied before entering other markets. There has also been some support of absenteeism, although not to the degree that one would expect to accompany the serious decline in a bank's relationship with its neighborhood.

The crucial question is whether increased dependence on branch banking activities as well as other influencing factors will contribute to an increase in those actions by the Dorchester Savings Bank which are not in the best interests of Dorchester. The answer is not clear. However, the bank's selection of a level of resident-owner lending may suggest that it is vulnerable to community pressure. If this is the case, then the crucial task for those in Dorchester who have a sincere hope for its future have a clear cut task ahead.

## CHAPTER V

## CONCLUSION

The analysis in the foregoing chapters indicates several critical points to be considered by those attempting to modify the current roles and activities of thrift institutions in Boston's housing market.

First, there is the question of the level of action. In most housing markets the flow of mortgage funds is dominated by federally chartered savings and loan associations. However, in Boston the large majority of potential mortgage funds are held by the state chartered institutions. Consequently, any action dealing with legislation and regulation must originate on the state level. Massachusetts does not have to wait for the federal government to solve many of the problems arising from the actions of thrift institutions in the mortgage market.

There is a second implication of the dominance of the mortgage market by state chartered institutions. Federal attempts to remedy problems in the mortgage market may have only marginal effects in Massachusetts. Often the federal government enacts policies that utilize federal savings and loan associations and/or the Federal Deposit Insurance Corporation in dominant roles. The relative small contribution to the mortgage supply in Massachusetts made by federal savings and loan associations dictates that any change in the policies of these institutions can, at most, make minor changes in the local market. Actions through the Federal Deposit Insurance Corporation will also have little effect in Massachusetts. With the exception of eight

savings banks almost all state chartered institutions insure their deposits through their own, state chartered deposit insurance agency. The total amount of money insured by FDIC (the deposits in all federal savings and loan associations, as well as those in eight mutual savings banks) are only a minor part of the total funds available for mortgages.

An example of this is President Nixon's program to pump an additional \$10.3 billion into the housing market, announced on May 10, 1974. Three billion dollars will be available to only federal savings and loan associations. Another \$4 billion will go only to thrift institutions insured by the Federal Deposit Insurance Corporation. The final \$3.3 billion is linked to the emergency housing Tandem Plan that went into effect January 22, 1974. The plan is designed to channel \$6.6 billion into new construction mortgage loans of \$35,000 or less. It is clear that very little of the first \$7 billion will find its way into Massachusetts due to the nature of her financial institutions. One can speculate that very little of the \$3.3 billion in the Tandem Plan will enter the state either. The upper limit of \$35,000 may find that most of the new construction in the state is too expensive to effectively utilize the money.

#### Regulation

In the past the legislative and regulatory process have not been actively used to solve many of the problems

associated with the mortgage market. The most important effect of the legislation is that it provides a "grocery list" of legal investments for these thrift institutions. They include: types of loans, stocks, bonds, government securities, etc. The legislation also provides upper limits for investment in particular assets. Generally, these upper limits are relatively useless since these institutions almost never approach them. A more useful type of limitation might be lower limits on certain investments. However, one should be careful not to over-restrict, rendering the regulated institution inflexible, and, as such, slow to respond to crisis.

The most effective method of limiting and encouraging investment has been through the tax laws. By effectively increasing or decreasing the yield on certain investments the state has significantly effected the portfolio composition decision. An example of this is the investment by Massachusetts banks in out-of-state FHA and VA mortgages. The total investment by Massachusetts savings banks in these assets as a percentage of total assets is much lower than the investment by savings banks in other leading savings bank states. Until it was repealed in 1966, Massachusetts law allowed mortgages on property within the state to be deducted from the amount of total deposits for certain taxation purposes.(61) Consequently, yields on in-state mortgages increased relative to those on properties out of the Commonwealth. After its repeal, savings banks



continued to maintain a lower investment in out-of-state assets.

A second example of the effects of tax law on investment portfolio concerns savings bank investments in government securities. Massachusetts savings banks invest significantly greater amounts in these as compared to corporate securities. Deposits invested in government securities are exempt from state deposit taxes. Consequently, they are much more attractive than corporate securities for portfolio investment. Although these two examples point to the successes of the utilization of tax laws to promote certain desirable investment policies, this may not always be the case. Lenders do not have to invest in the less desirable mortgages. As long as demand for lower risk mortgages is high and the yield is sufficient, the effects of tax incentives may be very small.

Regulation and legislation, alone, will not solve the problems of urban housing markets. It is not enough to require that an institution follow certain practices. Incentives must be provided along with regulation. It is clear that in the past the most effective attempts to regulate have been those which were incentive-oriented. i.e. tax laws. This successful practice should be continued. Institutions must be encouraged not to look for the "loop holes" in the regulations that they do not like. Potentially, one of the most effective methods of control of lending institutions is this "carrots and sticks" policy. However,

not only must we improve our incentives for action but we must also make major changes in our general regulatory approach.

Currently, in Massachusetts, the regulatory function of the State Commissioner of Banks is performed with a minimum of innovation. Examination of the regulations leaves little doubt that their only purpose is to describe the "how to" aspects of those things that the legislature allows banks to engage in. Never are regulations utilized to encourage solutions to various inadequacies in the mortgage supply. Clearly, the use of regulatory power is untapped as to its potential use to deal with many of the problems of the housing market.

At this time, the most needed of all banking legislation is a "Disclosure Law" such as Massachusetts House Bill 5597. It would require that financial institutions disclose the locations and levels of deposits and mortgage loans by wards, towns, and cities.

Its power lies not in requiring the banks to do certain things, but instead, in simply requiring them to make public their actions and accept the consequences. With such a law, the data for much of this thesis, rather than taking months to collect, would have been part of the public record. Currently, one of the largest problems in dealing with issues like "redlining" and disinvestment is the difficulty in obtaining concrete information to document them. It is much easier for a bank to follow these

policies if it knows that there is little chance that it will have to answer publically for its actions.

In the past, public pressure has been used to encourage banks to examine their lending policies. In Chicago, they have been successful in getting the Federal Home Loan Bank Board to do a study on disinvestment by savings and loan associations.(62) A Minneapolis-St. Paul coalition of community groups was able to increase central city lending from \$19 million to \$85 million. It offered as an incentive, a pledge of \$2.3 million in new deposits.(63) In Boston, the Codman Square Civic Association is attempting to pressure the Dorchester Savings Bank into increasing its investments in Dorchester. While many of the community groups have had some successes, it is clear that such successes are limited and that something more is needed. In many cases, that something more is a "disclosure law". With it, community organizations will have a factual basis for many of their claims resulting in a stronger bargaining position. With the law they will begin to be able to apply effective pressure on the banks, the legislative body, and the regulatory agency. This is where much of the key to success lies. The root of all change must come from within the community where the ultimate pressure for solutions and answers must originate. Outraged citizens must voice their disapproval of current banking policies. Bank officials must be called upon to defend their actions. The decision to "redline" or to support absentee owners must be as difficult as the decision not to.

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# FOOTNOTES

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- 11) Maisel, p. 52.
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